

Solvency Margin

14 September 2006

Introduction

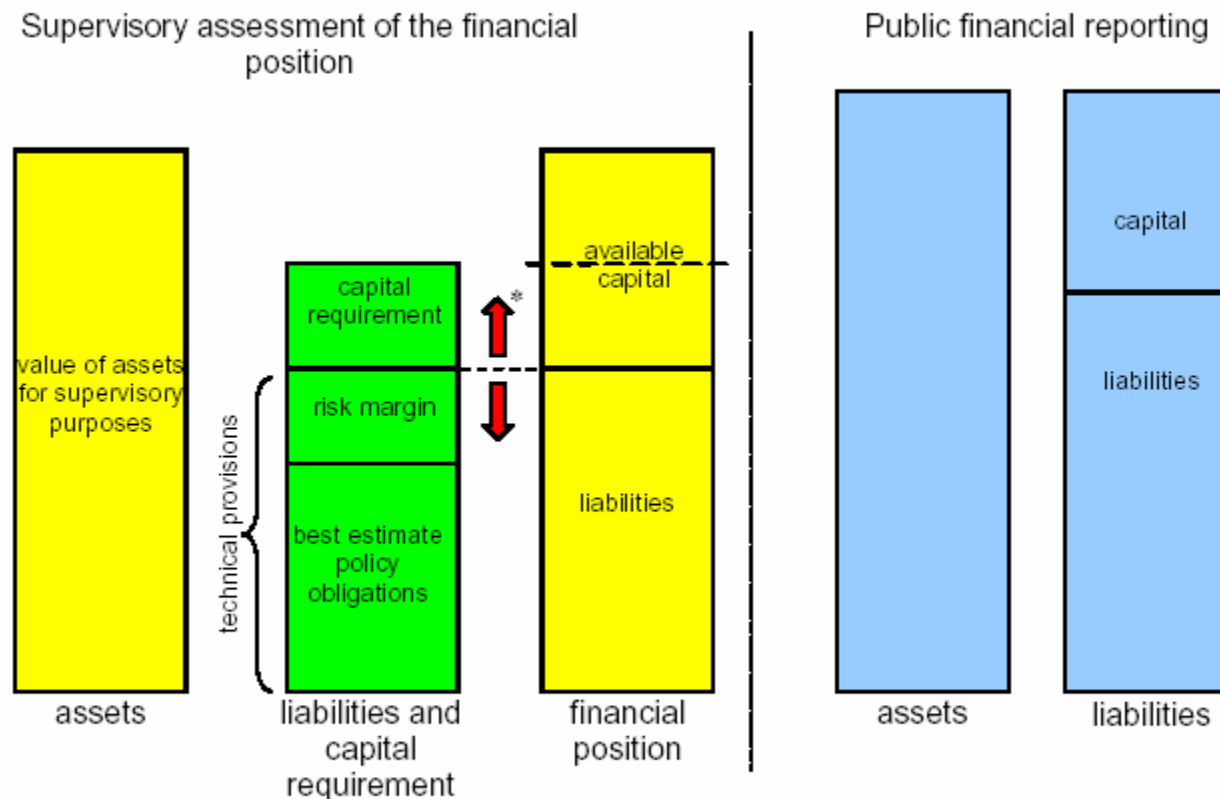
- The three papers presented in this part of the seminar address three related but different issues:
 - The presentation by Jamshaid Islam addresses the overall approach to solvency.
 - Jawwad Farid's presentation tries to learn a lesson from the approach taken by banks,
 - Manzoor Sahib has dealt with more micro level (and perhaps practically more immediate) issues relating to asset admissibility in the present regime.
- Before considering the papers itself I will take the liberty of presenting 3-4 slides on the concept of solvency itself, along with a short summary of efforts being made internationally towards introducing a common regime. This is then followed by my views on the three presentations.

Rationale for Solvency Margins

- Why Do We Need Solvency Margins ?
- Simple Answer – to protect the insured by ensuring that an insurer is financially capable of meeting its obligations.
 - Not the same thing as ensuring that an insurer DOES meet its obligations which is covered by other aspects of insurance supervision
- As Jamshaid has very capably summarized, different jurisdictions have adopted different approaches to trying to meet this objective.
- With increasing globalization, however, the International Association of Insurance Supervisors (IAIS) are working on a project to converge the approach to ensuring the solvency of insurance companies.

Relationship of Solvency Assessment and Financial Reporting

Figure 2: The supervisory assessment of the financial position of an insurer and the public financial reporting of an insurer



* Risk factors may lead to a financial charge in technical provisions and/or in capital. The arrows do not imply that such charges are necessarily substitutable on a one-for-one basis. The IAIS will explore this issue in further work.

Principles on Capital Adequacy and Solvency

- The IAIS has a paper on the above dated January 2002 which contains 14 principles which are worth reviewing and considering.
- In considering an appropriate solution in our environment we must consider the following:
 - The fact that some risks, including that of asset concentration, are addressed through restricting the admissibility of assets for solvency purposes
 - The statutory fund structure with solvency requirements both at the fund as well as shareholder fund level
 - The fairly diverse experience (and thereby approaches) taken by various appointed actuaries.

Considerations

- In my opinion any approach must be
 - Technically correct. Thus over-simplistic approaches are to be avoided, even if they have the advantage of ease of implementation. Specifically the relationship of assets and liability must be considered rather than the simplistic approach of treating assets and liabilities separately.
 - Precise. As much as one would like to leave everything to the discretion of appointed actuaries, I believe that currently there is a need to specify parameters in enough detail to ensure that actuaries are consistently conservative.
 - Capable of being implemented, i.e., not overly complex.
 - Capable of Supervision. With the more complex approach being suggested, the role of the SECP will be more difficult. This can be overcome by more complete and detailed disclosure of the way risks have been assessed and mitigated against.

Opinion

- I believe that the right way forward for Pakistan is:
 - For the SECP to provide detailed guidance (with possible values) for elements for which risks relating to an insurer are to be evaluated (eg., interest rate risk, inflation risk, etc)
 - For the appointed actuary to apply such techniques, within the limits of the SECP's guidelines, to ascertain the extent to which a life insurer is faced with certain risks and to determine a value of an amount which is to be set aside to meet such risks
 - For the technique and values to be disclosed in the FCR
- Although important, I am not sure that we are ready for setting capital aside to meet operational risk.
 - We have not really managed to enforce S12 relating to fit and proper persons in management
 - Suggest that this aspect be kept on the back-burner for the time being

Admissibility of Assets Issues

- I believe that the admissibility of assets aspect in the Insurance Ordinance and Rules needs serious re-examination.
- I do, however, strongly support the general approach to mitigating concentration risk with respect to assets by limiting the proportion of funds invested
 - Although there is possibly a need to introduce a floor
- I therefore do not support the view that there should be no limit on investment in single entities
- I do believe that the 5% limit on a single asset relates to a single instance of investment in an asset as opposed to an asset class.
 - Hence the 5% would relate to investment in a single bank and not in all banks
- Manzur Sahib has brought up some practical instances of difficulty. I would, perhaps, consider exempting funds in transit, although I would define the transit period as, perhaps, 14 days.
 - I would not support any suggestion that the limit of investment in any one bank be more than 5%.

Admissibility of Assets Issues

- I also do not support the weakening of limits on the admissibility of investment in properties. I do believe that there is an urgent need to reduce the limits for non-life, but do not agree with the suggestion that limits for life insurers be adjusted upwards.
- I support the move towards valuation of all life insurance assets (including available for sale investments) at fair value (per IAS 39)